


**MEMORANDUM**

October 6, 2011

TO: Transportation, Infrastructure, Energy and Environment (T&E) Committee

FROM:  Keith Levchenko, Senior Legislative Analyst

SUBJECT: FY13 Washington Suburban Sanitary Commission Spending Control Limits

**FY13 Spending Control Limits Summary**

	<b><u>WSSC "Base Case"</u></b>	<b><u>Council Staff Recommendation</u></b>
<b>New Debt:</b>	<b>\$481.764 million</b>	<b>\$481.764 million</b>
<b>Debt Service:</b>	<b>\$212.714 million</b>	<b>\$212.714 million</b>
<b>Total W/S Operating Exp.:</b>	<b>\$628.999 million</b>	<b>\$628.999 million</b>
<b>Maximum Avg. Rate Increase:</b>	<b>9.2 percent</b>	<b>8.5 percent</b>
<b>Average Residential Monthly Impact:</b>	<b>\$5.99</b>	<b>\$5.50</b>

The following officials and staff are expected to attend this meeting.

- WSSC Vice Chairman: Dr. Roscoe Moore (invited)
- WSSC Commissioners: Gene Counihan, Adrienne Mandel
- Jerry Johnson, General Manager/CEO
- Thomas Traber, Chief Financial Officer
- John Greiner, Office of Management & Budget

**Background**

- Annual process was established in April 1994 via resolution by both Councils. Goal is for both Councils to agree upon certain budgetary limits by November 1 of each year.
- Based on a multi-year planning model, a strategy to stabilize annual rate increases over time, and holding customer fee-supported debt service below 40 percent of the operating budget.

- 4 limits
  - Maximum Average Rate Increase
  - Debt Service
  - New Debt
  - Total Water and Sewer Operating Expenses
- Limits provide direction to WSSC as to what to request, but do not create a ceiling (or a floor) as to what the Councils may jointly approve later.<sup>1</sup>
- Process has generally worked well over the past 15 years, although Councils did not agree on limits in FY02, FY06, and FY09, FY10, and FY11. Even in years when there was not agreement, the process provided a rate increase range for WSSC to build its budget.
- Debate focuses on the average rate increase for the coming year and the rate implications for the out years. The other limits are then adjusted to take into account the impacts of the rate decision.

#### **Schedule**

- Bi-County Working Group Meetings: September 7 and September 21
- MC Council Public Hearing: October 4
- T&E Committee Discussion: October 10
- Council Action: October 18

***NOTE: A recommendation from the County Executive on WSSC's spending control limits is expected to be transmitted to the Council prior to the T&E Committee discussion.***

The goal of the spending control limits process is to reconcile the Montgomery and Prince George's County Councils' actions (if necessary) by November 1 of each year, so that WSSC can build the approved limits into its Operating Budget Public Hearing Draft, which is released by January 15 each year. WSSC must transmit an Operating Budget to both counties by March 1 of each year.

#### **Spending Control Limits History**

The following chart presents the rate increase limits agreed upon by both Councils (unless otherwise noted) since FY96 and the actual rate increase later approved for each fiscal year.

---

<sup>1</sup> State law defines the annual WSSC Proposed Budget as the "default" budget, should the Montgomery and Prince George's County Councils not agree on changes. Therefore, the limits are an important first step to define proposed budget parameters that are acceptable to both Councils.

### WSSC Annual Rate Increase History

Fiscal Year	Rate Increase	
	Approved* Limit	Actual
FY96	3.0%	3.0%
FY97	3.0%	3.0%
FY98	3.0%	2.9%
FY99	2.0%	0.0%
FY00	1.5%	0.0%
FY01	0.0%	0.0%
FY02*	2.0%	0.0%
FY03	0.0%	0.0%
FY04	0.0%	0.0%
FY05	3.0%	3.0%
FY06*	2.5%	2.5%
FY07	3.0%	3.0%
FY08	5.3%	6.5%
FY09*	9.7%	8.0%
FY10*	9.5%	9.0%
FY11*	9.9%	8.5%
FY12*	9.9%	8.5%

\*No agreement was reached in FYs 02,06,09,10,11&12.  
Limits shown for those years reflect Montgomery County Council recommendations.

- **FY99 through FY04:** Although rate increases were assumed in the approved spending control limits for FY99 and FY00, the WSSC budget was approved in those years without rate increases. In fact, there were six straight years without rate increases (FY99-FY04). During this time, WSSC was implementing its Competitive Action Plan (CAP) effort, which resulted in a reduction in approximately 1/3 of its workforce.
- **FY05 through FY07:** Modest rate increases in the range of 2.5% and 3.0% were approved.
- **FY08 through FY12:** The Councils debated, and ultimately approved, substantial rate increases. These increases were the result of a combination of factors, including:
  - Flat revenues: WSSC's water production has been largely flat in recent years, even as the number of customer accounts has increased.
  - Expenditure Pressures: Increases in excess of inflationary levels in areas such as debt service (to cover many capital needs, including WSSC's need to ramp up WSSC's water and sewer main reconstruction efforts and its large diameter water main inspections, repairs, and monitoring program), as well in many operating cost areas, including: chemicals, heat, light, and power, regional sewage disposal, and benefits and compensation.

### General Issues

#### Economic Indicators

Each year the Council considers the bi-county economic context in order to place the concept of affordability in clearer perspective. The Finance Department's most recent update on economic indicators was in August.

While the national economic recession officially ended in June 2009, unemployment remains above 9 percent and, by a broader measure including part-time and discouraged workers, above 16 percent. In recent months, growth has been sluggish, while the stock market has fallen sharply. The County unemployment rate averaged 5.3 percent in FY11, well below the national rate, but it was just 2.5 percent in November 2007 and, until January 2009, had not reached even 4 percent at any time in at least 20 years. Resident and payroll employment both experienced small increases in FY11, the first increases since FY08.

Sales of existing homes, which fell by more than half between 2004 and 2008, rose in 2009 with the first-time homebuyers' credit. Sales were up 28.5 percent in FY10 but fell 17.6 percent in FY11. Average sales prices were up 6.1 percent in FY11 after declines of 16.2 percent and 5.4 percent in FY09-10. Residential and non-residential construction starts were up sharply in FY11 but from a very low base. Sales tax receipts were up 4.3 percent. The CPI-U was up 4.1 percent, or 2.8 percent excluding food and energy purchases.

Regarding pressures on the disposable income of County residents, energy costs remain a key factor. Gasoline prices, currently declining, remain much higher than in recent years. Significantly higher costs for heating and electricity will also persist. Rising health insurance costs are another factor.

**In the context of the spending control limits discussion, it is important to keep in mind current economic conditions and their impact on WSSC ratepayers, especially in the context of potential water and sewer rate increases and the cumulative impact on ratepayers of these increases, combined with possible increases in other County taxes and fees.**

#### Multi-Year Context

While the spending control limits process is an annual process, the Bi-County Working Group takes a multi-year look at trends. The outyear estimates help staff identify issues that could arise in future years. For instance, rate increases in the first year help improve WSSC's fiscal situation in future years by increasing WSSC's base revenues. Conversely, deferring rate increases to future years, or using one-time revenue to reduce a rate increase in the first year, increases future fiscal challenges, since the revenue base is lower in future years.

**However, with flat water and sewer consumption revenue combined with ongoing capital needs (and corresponding increases in debt service requirements), as well as increased costs for many operating categories, WSSC continues to face significant fiscal challenges.**

#### Infrastructure Fee

During the FY09 budget process, the issue of creating a dedicated fee to accelerate WSSC's water and sewer main reconstruction program was discussed, but no fee was ultimately proposed by WSSC. A Bi-County Working Group was established at that time to study the issue. However, to date, no fee has been formally pursued by WSSC nor approved by either Council. The Bi-County Working Group is currently working with the assistance of a consultant, and recommendations regarding an infrastructure fee may be forthcoming during FY12.

### FY13 Spending Control Limits Base Case Summary

For the upcoming budget, WSSC staff prepared a base case spending control limits scenario (see ©1-3), based on its latest projections of revenue and expenditures and the General Manager's initial considerations regarding current programs and potential new and expanded programs. This base case scenario assumes the following limits:

<b>New Debt:</b>	<b>\$481.764 million</b>
<b>Debt Service:</b>	<b>\$212.714 million</b>
<b>Total W/S Operating Expenses:</b>	<b>\$628.999 million</b>
<b>Maximum Average Rate Increase:</b>	<b>9.2 percent</b>

This scenario assumes:

- Full funding of WSSC's Proposed FY13-18 Capital Improvements Program, which was transmitted on September 26, 2011.
- Inflationary increases in current programs.
- Increases in regional sewage disposal, GASB 45, and employee compensation.
- Approximately \$5.9 million (\$4.5 million in operating dollars) for new and expanded programs. See ©5 for a summary of these items.
- Use of \$8.5 million in excess fund balance in FY13 to offset rate revenue shortfalls.

As shown in the following chart, the base case scenario assumes a funding gap of approximately \$54.8 million, which translates to a 10.9 percent rate increase. However, WSSC's base case assumes to offset a portion of this increase by utilizing \$8.5 million in excess fund balance in FY13, to offset a portion of this gap caused by lower than previously assumed rate-related revenue. The resulting gap (\$46.2 million) is assumed to be closed through the 9.2% rate increase.

<b>Contributors to the FY13 Base Case Gap</b>	<b>Change from FY12 (in Millions)</b>	<b>Impact on Rate</b>
Revenue Decrease from FY12	7.55	1.50%
Debt Service	26.82	5.33%
Regional Sewage Disposal	1.83	0.36%
GASB 45 Ramp Up	1.00	0.20%
New and Expanded Programs	4.50	0.90%
Salaries and Wages	4.90	0.97%
All Other	8.17	1.62%
<b>Total Base Case Gap</b>	<b>54.76</b>	<b>10.89%</b>
use of fund balance to offset billing factor reduction	(8.54)	-1.7%
<b>Net Gap after use of Fund Balance</b>	<b>46.23</b>	<b>9.19%</b>

A 9.2% rate increase is estimated to increase an average residential monthly bill by \$5.99 (from approximately \$68.44 to \$74.43), assuming 210 gallons per day of water usage.

The elements of the base case rate increase are broken out on ©6. This chart shows that several cost categories which are essentially fixed costs (at least in the short run), such as debt service (5.33% rate impact), regional sewage disposal (0.36% rate impact), and contributions to retiree health insurance

benefits (i.e., GASB 45) (0.20% rate impact), combine for a rate impact of 7.4% when combined with revenue changes.

Future year increases under this scenario (see ©2 line 17) would be 12.1% in FY14, 8.9% in FY15, 8.9% in FY16, 7.5% in FY17, and 6.2% in FY18.

Also of note is that the debt service to budget ratio would creep up from 33.8% in FY13 to 42.5% in FY18 under the base case (see ©2 line 16). As mentioned earlier, one of the goals of the spending control limits process is to keep debt service below 40% of the budget. However, growth in debt-related spending (for both above-ground and below-ground infrastructure) is causing this ratio to increase over time. **This debt service ratio trend is one reason WSSC has reassembled the Bi-County Infrastructure Working Group to consider new strategies for addressing infrastructure needs over the next 10 to 20 years (as discussed earlier).**

### **Building the Base Case Scenario**

The first step the Working Group took in reviewing spending control limits and the base case scenario was to review the major revenue and expenditure assumptions for WSSC. Many of these items are the same as in past years. These assumptions involve various inflators assumed in categories such as salaries and wages, construction inflation, Blue Plains operating costs, and others.

**While one can debate particular budget assumptions, the Working Group was satisfied that the assumptions used are reasonable, based on current information. It should also be noted that marginal changes in the assumptions are not likely to greatly affect the results of the different scenarios. As discussed later, potential expenditure reductions are identified that would affect these assumptions.**

These assumptions were used by WSSC staff to develop the “base case scenario”, are presented on ©1-3, and are discussed in more detail below.

### **Fund Balance and Rate Stabilization**

Each year, WSSC carries over fund balance from the prior year. The FY11 carryover into FY12 is estimated to be about \$83.7 million. The following chart shows how WSSC is proposing to allocate these dollars.

<b>Estimated FY12 Excess Fund Balance Calculation (in \$000s)</b>	
<b>FY11 Carryover</b>	<b>83,735</b>
FY11 Reserve Requirement	28,000
FY12 Operating Reserve Increase	3,400
<b>Unallocated Reserve (end of FY12)</b>	<b>52,335</b>
Increase Reserve to offset billing Factor Reduction in FY13	(8,525)
Increase Reserve to offset billing Factor Reduction in FY14	(8,525)
FY13 Operating Reserve Increase	(5,200)
FY14 Operating Reserve Increase	(5,100)
FY15 Operating Reserve Increase	(6,000)
Additional Operating Reserve Increase in FY13	(5,000)
<b>Estimated FY12 Excess Fund Balance</b>	<b>13,985</b>

The above chart includes the following components:

- **An increase in the reserve requirement from \$28.0 million to \$31.4 million**, consistent with assumptions from last year's spending control limits process. This new amount results in a fund balance ratio of about 5.4% of total revenues.

Several years ago, WSSC recommended allocating excess fund balance to increase the designated reserve over time from 5 percent up to 10% of operating revenues. This goal is desired based on discussions with rating agencies and WSSC's interest in having sufficient working capital to overcome a potential short-time revenue shortfall. Two years ago, the Council agreed to a similar goal for its Tax-supported Fund Balance.

For FY13, the \$31.4 million reserve is about \$19 million short of WSSC's 10% goal. Given rate increases in recent years and projected rate increases going forward, WSSC will need to increase its annual bump ups in fund balance in order to gain ground on its 10% goal.

Since WSSC still has substantial reserves (about \$87 million) in its General Bond Debt Service (REDO) account (which it draws down each year to buffer rates), WSSC believes the 10% general reserve goal is not critical to achieve immediately. However, as the REDO dollars are drawn down, the general reserve should be brought up.

- **The resulting excess fund balance available for FY13 uses is estimated at \$52.3 million.** This amount is far greater than last year's excess balance (about \$18.3 million). The surplus is the result of several factors, including: lower than expected interest rates (reducing the cost to borrow money for the CIP) and delays in some program expenditures (such as EAM/ERP).
- **WSSC recommends using \$17.05 million** (\$8.5 million in excess fund balance in both FY13 and FY14) to offset lower than previously assumed "billing factor" assumptions for WSSC's rate-related revenue.
- **WSSC recommends an additional \$21.3 million over the next three fiscal years** to bump up the fund balance to total revenue ratio closer to the goal of 10%.

- The remaining excess fund balance after all of the above actions is estimated at approximately \$14 million.

Council Staff believes the remaining balance, \$10.8 million, should be targeted toward one-time or non-recurring costs (rather than rate relief). As assumed for FY11 and FY12, excess fund balance could continue to be used to partially cover EAM/ERP project costs. A decision on the use of excess fund balance can be made during the budget process this spring.

## Revenues

Total revenue (assuming no use of fund balance) is expected to be down from FY12 by approximately \$7.5 million, as shown on the following chart. This revenue drop requires the equivalent of approximately a 1.5 percent rate increase.<sup>2</sup>

**WSSC Total Revenue (FY12 Approved and FY13 Projected)**

Revenue	FY12	FY13	change	% change
Water and Sewer Rate Revenue	510,506,000	502,848,000	(7,658,000)	-1.5%
Interest Income	4,000,000	4,000,000	-	0.0%
Account Maintenance Fee	22,850,000	22,850,000	-	0.0%
Other Fees	8,176,000	8,227,000	51,000	0.6%
Miscellaneous	12,760,000	12,920,000	160,000	1.3%
<b>Total Revenue</b>	<b>558,292,000</b>	<b>550,845,000</b>	<b>(7,447,000)</b>	<b>-1.3%</b>
equivalent rate impact:			1.48%	

WSSC's most important revenue-related assumption is its estimated water production in millions of gallons per day (mgd). WSSC produces approximately 170 million gallons per day (62 billion gallons per year). This production (minus unbilled water), multiplied by a billing factor, determines water and sewer rate revenue. This revenue is more than 90% of all WSSC revenue. On average, every 1 mgd produced provides approximately \$2.96 million in annual revenue.

The decline in revenue is the result of continued flat water consumption levels and a reduction in the effective "billing factor".<sup>3</sup>

WSSC staff are assuming water production to be the same for FY13 (170 mgd) as assumed in FY12, with slight increases assumed in the out years (based on gradual increases in the customer base). In fact, over the past 15 years, WSSC's water production growth has been nearly flat (increasing about 1.4% in total over that time), even as the population served has increased over 20 percent.

However, water production is extremely sensitive to various factors, such as weather conditions and customer choices. WSSC's graduated rate structure (in which the more water one uses, the more one pays for all water used) provides a major conservation incentive, and WSSC's flat water production,

<sup>2</sup> For FY13, each 1% increase in rates raises approximately \$5.03 million in revenue.

<sup>3</sup> Complicating any projection of water production revenue is WSSC's graduated rate structure and the fact that in any given year, the average mix of customers at different rate levels may change. Based on recent rate revenue experience, WSSC has lowered its "billing factor" for its FY13 revenue projections and beyond.



even as the number of customers has increased, may be reflective of successful long-term water conservation efforts in the region.

For FY11, average daily water production averaged 175 mgd, which was higher than original budget assumptions of 170 mgd. WSSC staff believes the FY11 number is an anomaly resulting from a one-time sale of water sold to the City of Rockville as a result of a major water main break and extremely dry weather conditions that led to increased water usage in the WSSC service area. Early FY12 water production numbers are below FY11 levels.

**Overall, WSSC's revenue trends continue to be flat. With regard to rate revenues, the WSSC customer base is increasing slightly but the billing factor appears to be falling slightly. Absent new revenue sources, future rate revenue is also likely to be modest or flat, given the minor increases in water production expected for the next six years. As a result, inflationary pressures alone result in additional rate increase pressure for FY13 and the foreseeable future.**

#### Expenditure Assumptions

Expenditure assumptions include both debt-related assumptions (interest rates, construction inflation, completion factors) to meet WSSC's Proposed FY13-18 CIP and ongoing operating cost assumptions (salary and wage increases, energy, Blue Plains operating charges, "All Other," etc.). These assumptions are noted on ©1, are similar to assumptions presented during last year's review, and are either consistent with historical levels of increase in these areas or are based on locked-in rates (such as energy costs).

In past years, PAYGO has been allocated with excess fund balance and with some rate revenue in order to try to bring down the debt service to budget ratio. However, fiscal pressures and relatively low interest rates have made PAYGO a less appealing option in recent years. No PAYGO is assumed in the spending control limits forecast for FY13 and beyond.

The salary and wages rate of increase assumed for FY13 (5%) is the same percentage assumed in the FY12 spending control limits last year. This increase would accommodate cost of living adjustments (COLAs) as well as increments, plus flexible worker pay consistent with WSSC's labor agreement (FY13 will be the third and final year of the current contract) and pass-throughs to non-represented employees. *For FY12, WSSC included COLA and merit increases for its union-represented workers in its Recommended Budget (as required by State law) but not for its non-union workers. The Montgomery Council recommended removing the compensation increases in the WSSC budget, but the Prince George's Council did not, and WSSC's compensation recommendations were funded in the FY12 budget.*

**While no decision on employee compensation for WSSC needs to be made at this time, Council Staff would note that this is an area where the WSSC budget may change from what is in the "Base Case" scenario.**

Benefit costs are included in the "All Other" expense category. During the annual operating budget review, the MFP Committee reviews all of the County agency compensation and benefit assumptions with the intent of treating each agency equitably.

Energy costs are expected to decline about 4.2% from FY12 to FY13. These costs are based on actual energy contracts and expected energy usage. WSSC is experiencing an increase in its energy requirements as a result of the implementation of a UV process at its water filtration plants, but these costs are being offset by lower energy costs per KWh.

The Blue Plains regional sewage disposal costs are expected to increase about 3.7% from FY12.

The multi-year implementation of GASB 45 (on an 8 year phase-in) requires an additional \$1.0 million added to the base budget in FY13 (with an additional \$1.0 million to be added in each of the following two years; FY14 and FY15).

With the exception of the cost increases noted above, “All-Other” costs are assumed to go up 4.0% per year. This is 1% less than assumed at this time last year. Within this category are health care costs, as well as employee benefits and regulatory compliance costs (including SSO compliance).

For comparison purposes, as noted in the economic indicators discussion earlier, the CPI-U for the DC area has increased by 4.1% over the past year (from July 2010 to July 2011).

**Overall, the expenditure assumptions noted above result in a rate increase requirement of about 8.9 percent. Combined with the rate impact of reduced funds available, the rate increase requirement to meet the requirements noted above is about 10.0%.**

Finally, WSSC did an initial review of its needs for new and expanded programs. Many of these programs relate to mandates such as the SSO consent decree or are needed to expand infrastructure replacement/repair efforts. The total FY13 operating expense impact of these efforts is estimated at \$4.5 million, with a rate impact of about 0.9 percent. A summary of these items is attached on ©5.

**Combining the rate increase requirements to address the reduction in rate revenue and increases in projected expenditures, along with the uses of fund balance as noted earlier, the total rate increase requirement is 9.2 percent.**

### **Alternative Scenarios**

As in past years, the Bi-County Working Group developed a number of scenarios, based on varying rate increases in FY13.

The following chart summarizes the revenue/expenditure gaps (Column E) at different assumed rate increases (Column A), and the ratepayer impact (Column F). As shown on the chart, a 10.9% rate increase (the base case assumption without use of fund balance) results in no gap. With use of fund balance assumed, the base case rate assumption drops to 9.2%. Any rate increase below 9.2% will result in a gap from the base case that must be addressed either through increased revenues, increased use of fund balance, or decreased expenditures.

For reference, each 1% added to the rate provides approximately \$5.03 million in revenue to the budget. Alternatively, each 1% reduction in the rate removes that amount in revenues for that year and future years. Each 1% rate increase results in about a 65 cent monthly impact to the average residential customer.

**Summary of Impacts At Different Rate Increase Levels**

A	B	C	D	E	F
Scenario	FY13 Rate Increase	Revenue Generated	Use of Fund Balance	Base Case Gap	Ratepayer Impact*
Base Case Gap>>>				<b>54,762,000</b>	
Impact of each 1% rate increase>>>	1.0%	<b>5,028,480</b>			\$0.65
Rate Revenue Adjustment Impact>>>	1.5%	7,542,720	8,525,000	38,694,280	\$0.98
Rev. Adjust.+Debt Serv./Reg Sewage Disp/GASB	7.4%	37,210,750	8,525,000	9,026,250	\$4.82
	8.0%	40,227,840	8,525,000	6,009,160	\$5.18
Base Case with No Additional/Reinstated Programs>>>	8.2%	41,183,250	8,525,000	5,053,750	\$5.34
"Same Services" plus CIP>>>	8.3%	41,736,000	8,525,000	4,501,000	\$5.37
FY12 Rate Increase>>>	8.5%	42,742,080	8,525,000	3,494,920	\$5.50
	9.0%	45,256,320	8,525,000	980,680	\$5.83
Base Case>>>	9.2%	46,236,000	8,525,000	-	\$5.99
Base Case with NO USE OF FUND BALANCE>>>	10.89%	54,762,000		-	\$7.09

\*Monthly impact based on avg. residential usage of 210 gpd & account maint. fee of \$11 per quarter. Current avg monthly residential customer cost = \$68.44

Column A shows how different levels of rate increase relate to the revenue and expenditure assumptions discussed earlier. For example, a 1.5% rate increase is required to cover estimated revenue adjustments between FY12 and FY13. A 7.4 percent rate increase is needed to cover the revenue adjustments plus several of the major cost areas. The rate increase goes up to 8.3% to cover a "same services plus CIP" budget (i.e., all of the inflators assumed in the Base Case plus debt service assumed in the recently proposed FY13-18 CIP). The 9.2% rate increase would also cover new and expanded programs that WSSC has identified (see ©5 for a summary of these items). WSSC has provided a chart on ©6 that shows how each major cost and revenue item builds into the base case rate.

### Closing the Gap

As noted earlier, any rate increase below the 9.2% rate will result in a gap from the base case that must be addressed either through increased revenues or decreased expenditures. Some of the feasible options for closing the gap are summarized in the following list:

- Revenues
  - Increase Reconstruction Debt Service Offset (REDO). *This has been done in past years, but since a sizeable amount is already assumed to be used each year, increases have tended to be marginal in size.*
  - Allocate excess fund balance to reduce the rate requirement. *WSSC is assuming over \$8.5 million in use of fund balance to offset revenue reductions. Additional excess fund balance is available. Note: In past years, the Councils have utilized additional excess fund balance to reduce the rate requirement. Council staff believes this action, if required, should be considered at the end of the budget process, rather than assumed up front in the spending control limits process.*
- Expenditures
  - Assume unspecified reductions to be determined later in the budget process.
  - Reduce new and expanded programs.
  - Reduce compensation assumptions.
  - Assume lower "All Other" costs Rate of Increase.

In past years, WSSC estimated that approximately 70 percent of its budget involves costs that would be extremely difficult, if not impossible, to cut in the short term. Three items alone – debt service, regional sewage disposal, and heat, light, and power – make up 46 percent of the FY13 base case expenditure assumptions, and increases in these categories require a 7.4 percent rate increase when combined with revenue adjustments from FY12.

### **Council Staff Recommendations**

Given WSSC's budget profile discussed earlier (i.e., its high level of fixed and/or mandated costs, its flat revenue projections, plus the need to make up for reduced funds available this year), Council Staff believes a significant rate increase is required to avoid unacceptable impacts on WSSC's mission and its ratepayers.

However, it is also important to consider the fiscal context all County agencies are facing this year. County Government and the other agencies had to do substantial belt-tightening in FY12 and will likely need to do more in FY13. Council Staff believes the spending control limits ceiling should be reflective of this context. Both Councils will have a chance to reconsider this ceiling during the regular budget process.

**Council Staff recommends a rate increase limit of 8.5% but no changes to the other limits. WSSC will need to do some reprioritization within its base case expenditure and/or revenue assumptions to address the \$3.5 million in reduced revenue to meet this limit. The Montgomery and Prince George's Councils can consider more specific budget actions as part of the budget review next spring and are free to agree upon lower or higher rates and expenditures at that time.**

**Council Staff supports including language in the spending control limits resolution, as was done last year, which notes the County's support for WSSC's large diameter pre-stressed concrete cylinder pipe (PCCP) inspection, repair, and fiber optic cabling program and its water and sewer main reconstruction programs.**

#### **Attachments**

KML:f:\levchenko\wssc\spending control limits\fy13sc\l&e sc1 10 10 11.doc

## ASSUMPTIONS

### WSSC's Multi-Year Financial Forecast

FY 2013 thru 2018 Forecast : Base Case (Lowered Interest Rates) - No Additional & Reinstated Programs (2)

	<u>FY 2013</u> <u>Proposed</u>	<u>FY 2014</u> <u>Estimate</u>	<u>FY 2015</u> <u>Estimate</u>	<u>FY 2016</u> <u>Estimate</u>	<u>FY 2017</u> <u>Estimate</u>	<u>FY 2018</u> <u>Estimate</u>
<b><u>WATER PRODUCTION</u></b>						
Yearly Growth Increment (MGD)	-	0.5	0.5	0.5	0.5	0.5
Estimated Annual Average Water Production (MGD)	170.0	170.5	171.0	171.5	172.0	172.5
<b><u>OPERATING FUNDS</u></b>						
Salaries & Wages Rate of Increase	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Heat, Light & Power Annual Expenses (includes savings from Energy Performance Program)						
Water (\$ thousands)	13,323	14,126	14,703	15,303	17,329	18,373
Sewer (\$ thousands)	10,901	11,558	12,030	12,521	14,178	15,033
Blue Plains (Regional Sewage Disposal) Rate of Increase	3.7%	3.7%	3.7%	3.7%	3.7%	3.7%
All Other - % Annual Increase	4.00%	5.00%	5.00%	5.00%	5.00%	5.00%
GASB 045 Expense	8,000	9,000	10,000	10,000	10,000	10,000
Water REDO (\$ thousands)	5,500	5,300	5,300	5,000	5,000	5,000
Sewer REDO (\$ thousands)	5,500	5,200	5,200	5,000	5,000	5,000
Work Years / FTE \$s	-	-	-	-	-	-
Operating Program	-	-	-	-	-	-
Capital Programs	-	-	-	-	-	-
<b><u>BOND FUNDS</u></b>						
Short-term Construction Note Rate	3.5%	4.0%	4.0%	4.0%	4.0%	4.0%
Long-Term Bond Interest Rate	5.5%	6.0%	6.0%	6.0%	6.0%	6.0%
Bond Life for Water and Sewer Bonds (yrs)	19	19	19	19	19	19
<b><u>CAPITAL EXPENDITURES RELATED PARAMETERS</u></b>						
Construction Inflation	0.0%	3.0%	3.0%	3.0%	3.0%	3.0%
Water Construction Completion Factor	80%	80%	80%	80%	80%	80%
Sewer Construction Completion Factor	80%	80%	80%	80%	80%	80%
Blue Plains Sewer Construction Completion Factor	80%	80%	80%	80%	80%	80%
ENR Construction Completion Factor	80%	80%	80%	80%	80%	80%
Reconstruction Completion Factor	100%	100%	100%	100%	100%	100%



**WSSC's Multi-Year Financial Forecast : Combined Water/Sewer Operating Funds Summary**  
**FY 2013 thru 2018 Forecast : Base Case (Lowered Interest Rate) with Additional & Reinstated Programs (2)**  
 Estimated Revenues and Expenditures (\$1,000)

	<u>FY 2012</u> <u>Approved</u>	<u>FY 2013</u> <u>Proposed</u>	<u>FY 2014</u> <u>Estimate</u>	<u>FY 2015</u> <u>Estimate</u>	<u>FY 2016</u> <u>Estimate</u>	<u>FY 2017</u> <u>Estimate</u>	<u>FY 2018</u> <u>Estimate</u>
<b>1 Revenue</b>							
2 Water & Sewer Rate Revenue	\$510,506	\$502,848	\$542,439	\$609,749	\$665,972	\$727,535	\$784,503
3 All Other Sources	64,479	79,914	73,950	66,378	61,570	61,076	61,100
4 Total Revenue	574,985	582,762	616,389	676,127	727,542	788,611	845,603
<b>5 Expenses</b>							
6 Maintenance & Operating	336,213	354,776	371,310	382,702	401,093	422,941	443,912
7 Regional Sewage Disposal	49,478	51,309	53,207	55,176	57,218	59,335	61,530
8 Debt Service	185,894	212,714	252,299	286,530	321,879	353,329	379,986
9 PAYGO	-	-	-	-	-	-	-
10 Additional Operating Reserve Contribution	3,400	10,200	5,100	6,000	6,800	7,700	8,700
11 Unspecified reductions	-	-	-	-	-	-	-
12 Unspecified reduction of future year's expenditure base	-	-	-	-	-	-	-
13 Total Expenses	574,985	628,999	681,916	730,408	786,990	843,305	894,128
14 Revenue Gap (Revenue - Expenses)	-	(46,236)	(65,527)	(54,282)	(59,448)	(54,694)	(48,524)
<b>15 Water Production (MGD)</b>	170.0	170.0	170.5	171.0	171.5	172.0	172.5
<b>16 Debt Service Ratio (debt service / budget)</b>	32.3%	33.8%	37.0%	39.2%	40.9%	41.9%	42.5%

	<u>FY 2012</u>	<u>FY 2013</u>	<u>FY 2014</u>	<u>FY 2015</u>	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2018</u>
17 Rate Increase	8.5%	9.2%	12.1%	8.9%	8.9%	7.5%	6.2%
18 Operating Budget	\$574,985	\$628,999	\$681,916	\$730,408	\$786,990	\$843,305	\$894,128
19 Debt Service Expense	185,894	212,714	252,299	286,530	321,879	353,329	379,986
20 New Debt	203,993	481,764	390,331	379,274	391,085	361,941	319,495

**NOTE:**

21 Impact of Rate Increase on Residential Monthly Bill with 210 gal/day usage

<u>FY 2012</u>	<u>FY 2013</u>	<u>FY 2014</u>	<u>FY 2015</u>	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2018</u>
\$5.05	\$5.99	\$8.55	\$7.06	\$7.71	\$7.07	\$6.26

**WSSC's Multi-Year Financial Forecast : Combined Water/Sewer Operating Funds Summary**  
**FY 2013 thru 2018 Forecast : Base Case (Lowered Interest Rate) with Additional & Reinstated Programs (2)**

Estimated Revenues and Expenditures (\$1,000)

	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
	<u>Approved</u>	<u>Proposed</u>	<u>Estimate</u>	<u>Estimate</u>	<u>Estimate</u>	<u>Estimate</u>	<u>Estimate</u>
<b>1 REVENUE</b>							
2 Water / Sewer Use Charges	\$510,506	\$502,848	\$542,439	\$609,749	\$665,972	\$727,535	\$784,503
3 Account Maintenance Fee (Ready to Serve Charge)	22,850	22,850	22,900	22,900	22,950	22,950	23,000
4 Interest Income	4,000	4,000	4,050	4,050	4,100	4,100	4,150
5 Plumbing/Inspection Fees	5,823	5,823	5,873	5,873	5,923	5,923	5,973
6 Rockville Sewer Use	2,353	2,404	2,444	2,438	2,509	2,536	2,567
7 Products & Technology	-	-	-	-	-	-	-
8 Miscellaneous	12,760	12,920	13,130	13,450	13,860	13,860	13,910
9 Total Revenue	558,292	550,845	590,836	658,460	715,314	776,904	834,103
<b>10 Adjustments to Revenue</b>							
11 Use of Fund Balance	3,400	18,725	13,625	6,000	1,500	1,500	1,500
12 Less Rate Stabilization	-	-	-	-	-	-	-
13 SDC Debt Service Offset	2,293	2,192	1,428	1,167	728	207	0
14 Reconstruction Debt Service Offset	<u>11,000</u>	<u>11,000</u>	<u>10,500</u>	<u>10,500</u>	<u>10,000</u>	<u>10,000</u>	<u>10,000</u>
15 Adjustments to Total Revenue	16,693	31,917	25,553	17,667	12,228	11,707	11,500
<b>16 FUNDS AVAILABLE</b>	<u>574,985</u>	<u>582,762</u>	<u>616,389</u>	<u>676,127</u>	<u>727,542</u>	<u>788,611</u>	<u>845,603</u>
<b>17 EXPENDITURES</b>							
18 Salaries and Wages	97,921	102,818	107,960	113,359	119,028	124,980	131,230
19 Salaries and Wages - Additional & Reinstated Programs	-	-	-	-	-	-	-
20 Heat, Light and Power	25,275	24,224	25,684	26,733	27,824	31,507	33,406
21 Regional Sewage Disposal	49,478	51,309	53,207	55,176	57,218	59,335	61,530
22 All Other	213,017	223,233	232,986	237,696	249,081	261,036	273,588
23 All Other - Additional & Reinstated Programs	-	4,501	4,680	4,914	5,160	5,418	5,688
24 Additional Operating Reserve Contribution	<u>3,400</u>	<u>10,200</u>	<u>5,100</u>	<u>6,000</u>	<u>6,800</u>	<u>7,700</u>	<u>8,700</u>
25 Unspecified reductions	-	-	-	-	-	-	-
26 Unspecified reduction of future year's expenditure base	-	-	-	-	-	-	-
27 Total Operating Expenses	<u>389,091</u>	<u>416,285</u>	<u>429,617</u>	<u>443,878</u>	<u>465,111</u>	<u>489,976</u>	<u>514,142</u>
28 Debt Service	185,894	212,714	252,299	286,530	321,879	353,329	379,986
29 Debt Reduction (PAYGO)	-	-	-	-	-	-	-
30 Total Financial Expenses	<u>185,894</u>	<u>212,714</u>	<u>252,299</u>	<u>286,530</u>	<u>321,879</u>	<u>353,329</u>	<u>379,986</u>
31 TOTAL GROSS EXPENSES (Operating & Financial)	<u>574,985</u>	<u>628,999</u>	<u>681,916</u>	<u>730,408</u>	<u>786,990</u>	<u>843,305</u>	<u>894,128</u>
32 NET EXPENSES	<u>574,985</u>	<u>628,999</u>	<u>681,916</u>	<u>730,408</u>	<u>786,990</u>	<u>843,305</u>	<u>894,128</u>
33 Revenue - Expenditure Gap before rate increase	-	(46,236)	(65,527)	(54,282)	(59,448)	(54,694)	(48,524)
34 Rate Increase	8.5%	9.2%	12.1%	8.9%	8.9%	7.5%	6.2%

(W)

(8)

## FY'13 Operating Ratios

### Capital to Operating Ratio

<u>Assumptions</u>	CIP	Reconstruction
Short -Term Interest Rate	3.5%	3.5%
Annual Amortization	5.0%	5.0%
Completion Factor	80%	100%
Desired Debt Service Savings	\$ 1,000,000	\$ 1,000,000
Capital Expenses to achieve above debt svc savings	\$ 14,705,882	\$ 11,764,706
Capital Expenses to achieve above debt svc savings @ 4.0% Short-Term Interest Rate	\$ 13,888,889	\$ 11,111,111

### Amount Needed to Impact Rates by X%

Water & Sewer Rate Revenue	\$ 502,848,000
% Desired to Impact Rates	1%
Amount Needed to Impact Rate by above %	\$ 5,028,480

### Revenue Received for each MGD of Water Production

Water & Sewer Rate Revenue	\$ 502,848,000
Water Production (in MGD)	170
Revenue Received per MGD of Production	\$ 2,957,929



## Increased FY'13 Expenditure Assumptions Over and Above Inflation Factor

### FY'13 Additional & Reinstated Programs:

#### New Workyears

##### Plant Operations

- 3 Water Plant Operators
- 2 Planner-Scheduler (AMP)

##### Maintenance

- 1 Customer Care (Maintenance) Unit Coordinator

##### Collections

- 2 Collection Field Specialist

##### Process Control - Network Security

- 1 Process Control Security Specialist Unit Coordinator

##### Consent Decree - FOG (Fats, Oils & Grease)

- 2 FOG Investigators

##### Property Management

- 1 Asset Strategy Manager (AMP)

#### 12 Total Workyears

	Cost	W/S Impact
<i>New Workyears Impact</i>	\$ 724,700	\$ 708,800
<i>Benefits</i>	217,400	212,600
<i>Miscellaneous Support Equipment</i>	4,500	4,400

#### Other Additional & Reinstated Programs

Watershed Access Road	500,000	500,000
Reservoir Shoreline Armoring	50,000	50,000
Condition Assessment - Piscataway Assets	75,000	75,000
On-Call Plumbers	318,000	318,000
Lateral Inspection Program	187,500	187,500
Forensics Contract	100,000	100,000
Corrosion Engineering Basic Ordering Agreement	250,000	250,000
Patuxent Reservoirs Buffer Property Management Study	100,000	100,000
Automated Fuel Dispensing & Accounting System	500,000	42,700
Administrative Materials	217,000	175,800
Materials Evaluation	200,000	104,000
Electronic Security Network Preventive Maintenance	200,000	162,000
Continuity of Operations Plans	1,000,000	810,000
Staff Augmentation - Recruitment	115,200	93,200
GIS Infrastructure	470,000	358,100
IT Storage Equipment	430,000	117,500
Automated Attendant Solution	100,000	82,000
Data Center Infrastructure Computer Equipment	180,000	49,200
<i>Total Other Additional &amp; Reinstated Programs</i>	<u>4,992,700</u>	<u>3,575,000</u>
<b>Total Additional &amp; Reinstated Programs</b>	<b>\$ 5,939,300</b>	<b>\$ 4,500,800</b>

Although Advanced Metering Infrastructure, Water Main Cathodic Protection, and Water Main Lining are new programs, they are included as part of the CIP. Therefore, the water/sewer impact of these new programs has been captured via debt service.

## Rate Increase Components

	FY 2012 Approved	FY 2013 Estimate	Dollar Change	Rate Impact	Description
<b><u>Revenue</u></b>					
Water & Sewer Revenue	510,506,000	502,848,000	(7,658,000)	1.52%	Decrease in billing factor.
Miscellaneous Revenue	20,936,000	21,147,000	211,000	-0.04%	Based on historical miscellaneous revenue
Use of Fund Balance	3,400,000	10,200,000	6,800,000	-1.35%	For operating reserve contribution
Use of Fund Balance	-	8,525,000	8,525,000	-1.70%	For billing factor reduction offset
SDC Debt Service Offset	2,293,000	2,192,000	(101,000)	0.02%	
<b><u>Debt Service</u></b>					
Debt Service (Existing Debt)	\$ 185,894,000	\$ 165,273,000	\$ (20,621,000)	-4.10%	
FY'13 New Debt		\$ 47,441,000	\$ 47,441,000	9.43%	Due to capital spending assumptions
<b>Debt Service Total</b>	<b>185,894,000</b>	<b>212,714,000</b>	<b>26,820,000</b>	<b>5.33%</b>	
<b><u>Expenses</u></b>					
All Other	206,017,000	215,233,000	9,216,000	1.83%	Assumed 4 % increase in All Other Costs
Salaries & Wages	97,921,000	102,818,000	4,897,000	0.97%	Assumed 5% increase in Salaries & Wages
Additional & Reinstated Programs		4,501,000	4,501,000	0.90%	
Regional Sewage Disposal	49,478,000	51,309,000	1,831,000	0.36%	
Operating Reserve Contribution	3,400,000	10,200,000	6,800,000	1.35%	
GASB 45	7,000,000	8,000,000	1,000,000	0.20%	Sixth year of eight year phase-in of GASB 45
Heat, Light & Power	25,275,000	24,224,000	(1,051,000)	-0.21%	Based on projection from WSSC Energy Manager.
Unspecified Reductions	-	-	-	0.00%	
				<b>9.20%</b>	